Decision Making

Psychology

How people actually decide, against how normative theory says they should.

Prospect theory describes decisions under risk: outcomes are evaluated as gains and losses from a reference point, with losses weighted more heavily and probabilities distorted.

LOSS AVERSION	REFERENCE	PREDICTS
~2:1	sets gain/loss	framing effects

- Loss aversion: losses weigh roughly twice as much as gains.
- The reference point determines what counts as a gain or loss.
- Framing the same choice as a gain or a loss reverses preferences.
- Small probabilities are overweighted; large ones underweighted.
- People are risk-averse for gains, risk-seeking for losses.
- Expected utility theory predicts none of this.

LOOK FOR IT

The same treatment described as '90% survive' or '10% die' produces different choices from the same people.

The endowment effect follows directly: giving something up is coded as a loss, so people demand more to sell than to buy.